

## Message Text

SECRET

PAGE 01 TOKYO 07733 01 OF 09 281012Z  
ACTION SS-25

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S E C R E T SECTION 01 OF 09 TOKYO 07733

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E.O. 11652: GDS  
TAGS: ECON, OCON  
SUBJECT: BONN SUMMIT PREPARATIONS

REF: TOKYO 07370

1. SUMMARY: THIS MESSAGE TRANSMITS TEXT OF JAPANESE STATEMENT FOR SCHULTZE GROUP PROMISED BY ECONOMIC PLANNING AGENCY COORDINATION BUREAU DIRECTOR GENERAL MIYAZAKI (REFTEL). TRANSLATION AND TYPING TOOK A LITTLE LONGER THAN ANTICIPATED. END SUMMARY.  
QUESTION: WHAT IS YOUR ASSESSMENT OF THE ECONOMIC SITUATION HALFWAY THRU 1978? AND WHAT IS THE OUTLOOK FOR SECOND-HALF 1978 AND 1979?

ANSWER:

1. RECENT ECONOMIC TRENDS.

LOOKING AT RECENT ECONOMIC TRENDS, THE ACCELERATED IMPLEMENTATION OF PUBLIC WORKS AND OTHER PROJECTS SINCE EARLY SECRET

SECRET

PAGE 02 TOKYO 07733 01 OF 09 281012Z

IN JFY 77 (BEGINNING APRIL 1, 1977) AND THE TWO SUPPLEMENTAL BUDGETS HAVE BEGUN TO HAVE EFFECT THROUGHOUT THE ECONOMY. INVENTORY ADJUSTMENT IS PROCEEDING APACE AND PRODUCTION AND SHIPMENTS LEVELS ARE UP FOR CONSTRUCTION MATERIALS AND OTHER SECTORS. THINGS ARE ALSO LOOKING BRIGHTER IN SUCH PRIVATE-SECTOR INDICATION AS PERSONAL CONSUMPTION, PRIVATE HOUSING INVESTMENT, AND PRIVATE PLANT

INVESTMENT, AND IT IS EXPECTED THAT THESE TRENDS WILL CONTINUE UPWARD. ACCORDINGLY, THE ECONOMY SEEMS ON THE ROAD TO RECOVERY, WITH THINGS GOING PRETTY MUCH AS ANTICIPATED BY THE GOVT.

2. THE ECONOMY IN JFY 78.

(1) IN JFY 78 RUNNING FROM APRIL 78 THRU MAR 79, A WIDE VARIETY OF FISCAL AND FINANCIAL MEASURES ARE TO BE IMPLEMENTED, INCLUDING AMBITIOUS EXPANSION OF PUBLIC WORKS INVESTMENTS, CONCENTRATING THESE INVESTMENTS EARLY IN THE YEAR, AND LOWERING INTEREST RATES, SUCH THAT IT IS ANTICIPATED THERE WILL BE STRONG LEVELS OF PUBLIC WORKS AND PRIVATE HOUSING INVESTMENT IN THE FIRST HALF OF THE YEAR WITH STEADY PROGRESS IN INVENTORY ADJUSTMENT. AS THESE EFFORTS HAVE AN INCREASING IMPACT ON THE PRIVATE SECTOR, IT IS EXPECTED THE ECONOMY WILL GROW STEADILY AND STRONGLY.

(2) IN THE SECOND HALF OF THE YEAR, AS THE IMPACT OF THESE POLICY EFFORTS MAKES ITSELF FELT THROUGHOUT THE ECONOMY, IT IS EXPECTED THAT THERE WILL BE OVERALL ECONOMIC RECOVERY, WITH GOOD RECOVERY IN PRIVATE-SECTOR DEMAND INCLUDING (A) STEADY EXPANSION IN PERSONAL CONSUMPTION OUTLAYS AS CONSUMER ATTITUDES TAKE A TURN FOR THE BETTER AS A RESULT OF EXPANDED PERSONAL INCOME, LESSENED FEARS ABOUT THE FUTURE, AND OTHER POSITIVE DEVELOPMENTS, (B)

SECRET

SECRET

PAGE 03 TOKYO 07733 01 OF 09 281012Z

ACCELERATED GROWTH IN PRIVATE PLANT INVESTMENT AS THE ELECTRICAL POWER AND OTHER NON-MANUFACTURING INDUSTRIES PUSH AHEAD FIRMLY WITH THEIR INVESTMENT PLANS AND AS INVESTMENT IS ALSO EXPECTED TO SHOW SOME PICKING UP IN MANUFACTURING INDUSTRIES AS A RESULT OF RECOVERY IN CAPACITY UTILIZATION RATE AND OF IMPROVEMENT IN BUSINESS MIND ON INVESTMENT, AND (C) SOME IMPROVEMENT IN PRIVATE INVENTORY INVESTMENT AS INVENTORY ADJUSTMENTS ARE COMPLETED AND DEMAND PICKS UP.

WITH ECONOMIC TRENDS GOING AS OUTLINED, THE FIRST HALF OF JFY 78 CENTERING UPON GOVT-LED RECOVERY AND THE SECOND HALF UPON PRIVATE SECTOR DEMAND RECOVERY FOR A SMOOTH RECOVERY PROCESS, IT IS EXPECTED THAT GNP GROWTH FIGURES WILL BE VIRTUALLY BALANCED FOR THE FIRST AND SECOND HALVES OF THE YEAR. ALTHOUGH THE FORECAST GROWTH RATE FOR JFY 77 IS SLIGHTLY OVER 5 PCT, THAT FOR JFY 78 IS ABOUT 7 PCT. MOREOVER, ALTHOUGH FORECASTS BY PRIVATE INSTITUTIONS HAVE GENERALLY BEEN LOWER THAN GOVERNMENTAL FORECASTS, AN INCREASING NUMBER OF THESE HAVE RECENTLY BEEN REVISED UPWARD.

3. THE ECONOMY IN JFY 1979.

ALTHOUGH THERE ARE A GREAT MANY UNCERTAIN FACTORS SUCH AS INTERNATIONAL ECONOMIC TRENDS AND OTHERS WHICH MAKE IT MOST DIFFICULT TO PREDICT THE JFY 79 ECONOMIC SITUATION WITH ANY DEGREE OF CERTAINTY, THE FOLLOWING DEVELOPMENTS ARE GENERALLY ANTICIPATED.

PRIVATE PLANT INVESTMENT IS EXPECTED TO GROW STILL STRONGER AS THE RECOVERY OF STABILITY IN PRIVATE-SECTOR DEMAND IS JOINED BY HIGHER OPERATING RATIOS, PROGRESS IN CAPITAL STOCK ADJUSTMENT, AND LIKE FACTORS. WITH THIS

SECRET

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PAGE 01 TOKYO 07733 02 OF 09 281019Z  
ACTION SS-25

INFO OCT-01 ISO-00 SSO-00 /026 W  
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O 280928Z APR 78  
FM AMEMBASSY TOKYO  
TO SECSTATE WASHDC IMMEDIATE 7544

S E C R E T SECTION 02 OF 09 TOKYO 07733  
EXDIS

ACTIVATION OF THE ECONOMY, PERSONAL CONSUMPTION OUTLAYS AND PRIVATE HOUSING INVESTMENT ARE ALSO EXPECTED TO SHOW STRONG EXPANSION. THUS IT IS FELT THAT THE JAPANESE ECONOMY WILL BE ABLE TO SUCCESSFULLY MAKE THE TRANSITION TO STEADY, MODERATE GROWTH AS THE ECONOMY EXPANDS FAVORABLY SUPPORTED BY EXPANSION IN PRIVATE-SECTOR AND OTHER DOMESTIC DEMAND ASPECTS TO ACHIEVE REAL ECONOMIC GROWTH IN EXCESS OF 6 PCT PER ANNUM.

QUESTION: HOW DO YOU ASSESS INFLATION MIDWAY THRU 78?  
AND WHAT IS THE OUTLOOK FOR SECOND-HALF 78 AND 79?

ANSWER:

1. WHOLESALE PRICES.

WHOLESALE PRICES HAVE BEEN VERY STABLE SINCE LAST YEAR WITH THE EASING OF DOMESTIC SUPPLY-DEMAND, THE YEN'S RAPID APPRECIATION, AND RECESSION IN INTERNATIONAL COMMODITY MARKETS.

LOOKING AHEAD TO SECOND-HALF 78 AND FIRST-HALF 79, SUCH FACTORS IMPLYING HIGHER WHOLESALE PRICES AS (A) RESTORED SUPPLY-DEMAND BALANCE RESULTING FROM DOMESTIC ECONOMIC RECOVERY, (B) THE IMPROBABILITY THAT WE CAN EXPECT FURTHER PRICE BENEFITS FROM CONTINUED RAPID APPRECIATION BY THE YEN, AND (C) THE LIKELIHOOD OF SOME PICKUP IN INTERNATIONAL

SECRET

SECRET

PAGE 02 TOKYO 07733 02 OF 09 281019Z

COMMODITY MARKETS ARE IN PART OFFSET BY FACTORS WHICH WILL WORK TO HOLD WHOLESALE PRICES DOWN, FACTORS SUCH AS THE REDUCED IMPORTANCE OF PERSONAL AND OTHER FIXED OVERHEAD EXPENSES AS OPERATING RATIOS IMPROVE. EVALUATING ALL OF THESE FACTORS TOGETHER, IT IS EXPECTED THAT WHOLESALE PRICES WILL RISE FASTER IN JFY 78 THAN THEY DID IN JFY 77, UP AN AVERAGE OF APPROX 2.7 PCT OVER THE YEAR. (BY WAY OF CONTRAST, THE MARCH 78 FIGURE WAS DOWN L.7 PCT FROM THE MARCH 77 LEVEL.)

2. CONSUMER PRICES.

CONSUMER PRICES HAVE BEEN STABLE RECENTLY WITH THE SETTLED WHOLESALE PRICES AND OTHER FACTORS.

LOOKING AHEAD TO SECOND-HALF 78 AND FIRST-HALF 79, IT IS EXPECTED THAT (A) CONSUMER PRICES WILL BE RELATIVELY SLOW-RISING AS A RESULT OF THE STABILITY IN WHOLESALE PRICES (THIS WHOLESALE STABILITY'S HAVING A LAGGED EFFECT ON CONSUMER PRICES), (B) SERVICE CHARGES FOR PERSONAL SERVICES AND THE LIKE WILL REMAIN STABLE, AND (C) THE IMPACT OF UTILITY RATES WILL CONTINUE MODERATE. AS A CONSEQUENCE, CONSUMER PRICES ARE EXPECTED TO BE BASICALLY STABLE, THE AVERAGE RATE OF INCREASE OVER JFY 77 APPROXIMATELY 6.8 PCT.

QUESTION: WHAT ABOUT UNEMPLOYMENT MIDWAY THRU 78, IN SECOND-HALF 78, AND IN 79?

ANSWER:

1. THE UNEMPLOYMENT SITUATION IS VERY SERIOUS, UNEMPLOYMENT STANDING AT 1.36 MIL PEOPLE OR 1.15 MIL SEASONALLY  
SECRET

SECRET

PAGE 03 TOKYO 07733 02 OF 09 281019Z

ADJUSTED IN FEB 78 (AN INCREASE OF 11.5 PCT OVER THE LEVEL OF FEB 77).

2. NEVERTHELESS, THERE ARE SIGNS OF RECOVERY IN HOURS OF OVERTIME AND THE RATIO OF OPENINGS TO APPLICANTS, BOTH FIGURES CONSIDERED INDICATIVE OF FUTURE EMPLOYMENT TRENDS.

- 76 77 78 78

HOURS OF OVERTIME (MANUFACTURING INDUSTRIES;  
1975 EQUALS 100) 131.9 140.0 142.9 143.4

RATIO OF OPENINGS TO APPLICANTS (ALL INDUSTRIES) 0.64 0.56 0.52 0.54

3. WHILE THIS IMPROVEMENT IS THE RESULT OF EXPANSIONARY TENDENCIES IN MINING AND MANUFACTURING INDUSTRIES, THE RATIO OF OPENINGS TO APPLICANTS IS EXPECTED TO FURTHER IMPROVE AND THE EMPLOYMENT SITUATION TO BE ALLEVIATED IN 78 AS FIRMS BECOME MORE POSITIVE ABOUT NEW HIRING IN LIGHT OF ANTICIPATIONS OF MUCH BETTER GROWTH IN JFY 78 THAN IN JFY 77.

4. AS A CONSEQUENCE, THE CURRENT FIGURE FOR UNEMPLOYED WORKERS OF 1.15 MIL IS EXPECTED TO BE REDUCED TO ABOUT 1.10 MIL AVERAGE OVERY JFY 78 (FOR AN UNEMPLOYMENT RATE OF APPROX 2 PCT). (IT SHOULD BE BORNE IN MIND, HOWEVER, THAT TRADITIONAL JAPANESE EMPLOYMENT PRACTICES INCLUDE A RELUCTANCE TO LET REDUNDANT WORKERS GO, SUCH

SECRET

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PAGE 01 TOKYO 07733 03 OF 09 281025Z  
ACTION SS-25

INFO OCT-01 ISO-00 SSO-00 /026 W  
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FM AMEMBASSY TOKYO  
TO SECSTATE WASHDC IMMEDIATE 7545

S E C R E T SECTION 03 OF 09 TOKYO 07733  
EXDIS  
THAT INDUSTRY CARRIES A CONSIDERABLE NUMBER OF UNDER-EMPLOYED WORKERS WHO SHOULD BE CONSIDERED ALONG WITH THIS 2 PCT UNEMPLOYMENT.)

5. ALTHOUGH NO FORECASTS HAVE BEEN DONE YET FOR JFY 79,

IT IS CONSIDERED DESIRABLE FOR JAPAN TO SEEK SUSTAINED GROWTH OF OVER 6 PCT PER ANNUM IN ORDER TO PROMOTE ASSURED EMPLOYMENT STABILITY. IF THIS TARGET IS ACHIEVED, IT IS ANTICIPATED THAT THE EMPLOYMENT SITUATION WILL SHOW CONTINUED IMPROVEMENT IN JFY 79.

QUESTION: WHAT IS THE OUTLOOK FOR JAPAN'S INTERNATIONAL BALANCE OF PAYMENTS MIDWAY THRU 78? FOR SECOND-HALF 78? FOR 79?

ANSWER:

1. ALTHOUGH EXPORTS HAVE BEEN STRONG RECENTLY, THIS IS MAINLY A RESIDUAL STRENGTH AS THE YEN'S APPRECIATION THRU SELF-ADJUSTING FLOATING EXCHANGE RATES HAS YET TO MAKE ITS IMPACT FELT IN EXPORTS, PLUS SUCH SPECIAL EXPORT-PROMOTING FACTORS AS (A) MORE ACTIVE LEAD TRADING IN  
SECRET

ANTICIPATION OF FURTHER RISES BY THE YEN, (B) AN EXPORT PUSH TO SHORE UP BOTTOM-LINE FIGURES FOR COMPANY ANNUAL REPORTS, AND (C) FEARS OF A U.S. WEST COAST LONGSHOREMEN'S STRIKE  
SECRET

SECRET

PAGE 02 TOKYO 07733 03 OF 09 281025Z

IN JULY. IMPORTS, ON THE OTHER HAND, REMAIN SLOW AS DOMESTIC PRODUCTION HAS YET TO GET BACK FULLY ON ITS FEET AND AS THE BENEFITS OF THE YEN'S APPRECIATION HAVE YET TO BE UTILIZED. AS A RESULT OF THIS JUXTAPOSITION, THE CURRENT ACCOUNT IS STILL SHOWING CONSIDERABLE SURPLUS, AND IT IS POSSIBLE THIS SITUATION MAY CONTINUE UNTIL MID-78.

2. NEVERTHELESS, EXPORTS ARE EXPECTED TO FALL OFF IN THE LATTER HALF OF THIS YEAR AS THE HIGHER YEN EXCHANGE RATE AFFECTS LESS-PRICE-ELASTIC GOODS. BY THE SAME TOKEN, IMPORTS ARE EXPECTED TO PICK UP WITH THE AGGRESSIVE EXPANSION OF DOMESTIC DEMAND, THE SERIES OF INITIATIVES TAKEN TO LIBERALIZE ACCESS TO JAPANESE MARKETS, AND OTHER LIKE FACTORS. AS A RESULT, IT IS HOPED THERE WILL BE SIGNS OF DIMINUTION IN JAPAN'S CURRENT ACCOUNT SURPLUS BY THIS FALL, AND THIS TREND SHOULD ALSO CONTINUE IN 79.

QUESTION: WHAT ARE THE FISCAL AND MONETARY POLICIES UNDERLYING YOUR ECONOMIC FORECASTS?

ANSWER:

1. FISCAL POLICIES

(1) FOR JFY 78

A. BUDGETARY SCALE OF YEN 34,295 BIL

- GENERAL ACCOUNT GNP GENERAL ACCOUNT/GNP
- (PCT)

JFY 77 YEN 29,346.6 YEN188,000 15.6  
JFY 78 34,295.0 210,600 16.3

SECRET

SECRET

PAGE 03 TOKYO 07733 03 OF 09 281025Z

JFY 78 RATE OF  
INCREASE OVER  
JFY 77 16.9 PCT 12.0 PCT

NOTES: 1. ACCOUNT AND GNP FIGURES ARE IN BIL YEN.  
- 2. THE JFY 77 GENERAL ACCOUNT FIGURE INCLUDES BOTH  
- SUPPLEMENTAL BUDGETS.

B. MAJOR INCREASE IN INVESTMENT EXPENDITURES

- JFY 77 JFY 78 77-78 RATE OF
- INITIAL INCREASE
- BUDGET

CURRENT EXPENDITURES YEN22,810.8 YEN26,783.8 17.4 PCT

INVESTMENT EXPEND. 5,703.5 7,511.2 31.7  
TOTAL 28,514.3 34,295.0 20.3

NOTE: FIGURES IN BIL YEN.

C. PROJECT TILT IN GOVERNMENTAL INVESTMENT AND FINANCING  
PLANNING

- JFY 77 JFY 78 77-78 RATE
- OF INCREASE

PROJECTS YEN 7,676.9 YEN 9,566.6 24.6 PCT

PUBLIC WORKS

SECRET

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SECRET

PAGE 01 TOKYO 07733 04 OF 09 281031Z

ACTION SS-25

INFO OCT-01 ISO-00 SSO-00 /026 W  
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FM AMEMBASSY TOKYO  
TO SECSTATE WASHDC IMMEDIATE 7546

S E C R E T SECTION 04 OF 09 TOKYO 07733

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ORGANIZATIONS	5,325.9	6,421.1	20.6
LOCAL SPENDING	2,351.0	3,145.5	33.8
LOANS	4,861.3	5,321.0	9.5
TOTAL	12,538.2	14,887.6	18.7

NOTE: FIGURES IN BIL YEN.

THERE HAS BEEN ESPECIALLY STRONG CONCENTRATION ON HOUSING FINANCE CORPORATION PROVISIONS (UP FROM 387,000 UNITS IN JFY 77 TO 550,000 UNITS IN JFY 78) TO STIMULATE THE ECONOMY.

D. MAJOR EXPANSION IN INVESTMENT EXPENDITURES IN LOCAL GOVERNMENT FINANCIAL PLANNING.

- JFY 77 JFY 78 77-78 RATE  
- OF INCREASE

LOCAL INVESTMENT YEN 10,038.4 BIL 12,559.4BIL 34.8 PCT

E. TAXATION MEASURES.

THESE INCLUDE BOTH (1) EFFORTS TO INCREASE TAX REVENUES AS BY UPPING LIQUOR TAXES, IMPOSING AN OIL TAX, ETC. AND (2) EFFORTS TO REDUCE SELECTED TAXES AS BY INCREASING THE HOME ACQUISITION DEDUCTION AND ALLOWING A BIGGER TAX CREDIT FOR

SECRET

SECRET

PAGE 02 TOKYO 07733 04 OF 09 281031Z

PLANT INVESTMENT.

F. ADVANCED IMPLEMENTATION OF PUBLIC WORKS PROJECTS.

THE TARGET HERE IS TO CONCENTRATE FULLY 73 PCT OF THE YEAR'S PUBLIC WORKS IN THE FIRST HALF.

(2) FOR JFY 79.

ALTHOUGH IT IS NOT UNLIKELY THAT JFY 79 WILL NEED A STRONG

STIMULATIVE ECONOMIC POLICY AS SUCH DEEMED NECESSARY IN JFY 78, IT IS STILL TOO EARLY TO SPECULATE UPON THE ACTUAL FISCAL POLICIES TO BE TAKEN IN JFY 79. HOWEVER, IF THE JAPANESE ECONOMY PROVES ABLE TO ACCELERATE THE PACE OF RECOVERY, ONE OF THE MORE IMPORTANT ISSUES WILL LIKELY BE THAT OF RESTORING GOVT FINANCES TO A SOUND FOOTING.

2. MONETARY POLICIES.

(1) FOR JFY 78.

SINCE A NUMBER OF MEASURES HAVE BEEN TAKEN RECENTLY TO EASE FINANCING, INCLUDING THE MARCH 78 REDUCTION OF THE OFFICIAL DISCOUNT RATE AND THE SUBSEQUENT LOWERING OF LONG-TERM INTEREST RATES, THE GOVT WILL WORK TO ENSURE THAT THESE MEASURES HAVE THEIR DESIRED IMPACT THROUGHOUT THE ECONOMY IN JFY 78.

(2) FOR JFY 79.

FUTURE MONETARY POLICY WILL BE DETERMINED FLEXIBLY TO RESPOND EFFECTIVELY TO PREVAILING ECONOMIC CONDITIONS.

SECRET

SECRET

PAGE 03 TOKYO 07733 04 OF 09 281031Z

UNLESS EVENTS TAKE A QUITE UNEXPECTED TURN, IT IS UNLIKELY THERE WILL BE ANY SHIFT TO TIGHT-MONEY POLICIES AIMED AT CHECKING EXCESSIVE PRICE INCREASES.

SECRET

QUESTION: WHAT KIND OF AN INCOMES POLICY UNDERLIES YOUR ECONOMIC FORECASTS?

ANSWER:

1. JAPAN HAS NEITHER IMPLEMENTED AN INCOMES POLICY IN THE

PAST NOR EXPECTS TO DO SO IN THE FUTURE.

2. AMONG THE REASONS FOR JAPAN'S AVOIDANCE OF AN INCOMES

POLICY MAY BE CITED:

- I. BOTH THE GOVERNMENT AND THE PEOPLE AT LARGE FEEL

- WAGES ARE SOMETHING TO BE DETERMINED INDEPENDENTLY BY  
- LABOR AND MANAGEMENT.

- II. WAGES IN JAPAN, AS WELL AS THE PRICES OF GOODS

- AND SERVICES, ARE VERY FLEXIBLE REFLECTING MARKET  
- SUPPLY AND DEMAND. FOR EXAMPLE, LOOKING AT THE  
- AVERAGE WAGE INCREASES NEGOTIATED DURING THE ANNUAL  
- SPRING ROUND, THESE ARE 15.3 PERCENT IN 1972, 20.1  
- PERCENT IN 1973, 32.9 PERCENT IN 1974, 13.1 PERCENT  
- IN 1975, 8.8 PERCENT IN 1976, AND 8.8 PERCENT IN

- 1977, SHOWING CONSIDERABLE FLUCTUATION WITH CHANGING
- ECONOMIC CONDITIONS.

3. AMONG THE FACTORS ACCOUNTING FOR THIS ARE (I) THE STRONG PUBLIC APPREHENSION ABOUT INFLATION AND (II) LABOR

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PAGE 01 TOKYO 07733 05 OF 09 281038Z  
ACTION SS-25

INFO OCT-01 ISO-00 SSO-00 /026 W  
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TO SECSTATE WASHDC IMMEDIATE 7547

S E C R E T SECTION 05 OF 09 TOKYO 07733

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PRACTICES PECULIAR TO JAPAN (INCLUDING LIFE-TIME EMPLOYMENT, SENIORITY-BASED WAGES, AND UNIONS ORGANIZED ALONG COMPANY RATHER THAN TRADE LINES).

4. AS A CONSEQUENCE, IT IS FELT MORE APPROPRIATE FOR THE GOVERNMENT TO UTILIZE AGGREGATE-DEMAND-MANAGEMENT POLICIES CENTERING UPON FISCAL AND MONETARY MEASURES TO STABILIZE PRICES, REFLATE THE ECONOMY, AND STABILIZE EMPLOYMENT. IN ADDITION, THE GOVERNMENT IS ALSO TAKING COMPETITION-STIMULATIVE POLICY INITIATIVES AND OTHER MEASURES TO FACILITATE THE SMOOTH WORKING OF MARKET MECHANISMS.

QUESTION: HOW ARE THE ADVANCED INDUSTRIAL NATIONS DOING ECONOMICALLY?

ANSWER:

1. EVEN THOUGH IT IS DIFFICULT TO BE ENTIRELY SATISFIED WITH THE ADVANCED INDUSTRIAL NATIONS' EXPERIENCE OVER THE PAST YEAR IN EMPLOYMENT, PRICES, OR ECONOMIC GROWTH, IT IS FELT THAT THEY HAVE OVERALL FIRMED UP THE BASES FOR INFLATION-FREE, ASSURED GROWTH. TO WIT, A NUMBER OF COUNTRIES HAVE MADE CONSIDERABLE PROGRESS IN RECTIFYING THEIR BALANCE OF PAYMENTS POSITIONS THROUGH EFFORTS FOR ECONOMIC STABILIZATION, AND THERE HAS ALSO BEEN CLEAR PROGRESS MADE IN HOLDING DOWN PRICES.

2. FOR THE FUTURE, IT IS IMPORTANT THAT THESE NATIONS

SECRET

SECRET

PAGE 02 TOKYO 07733 05 OF 09 281038Z

MAKE FURTHER EFFORTS TO ACHIEVE ASSURED, INFLATION-FREE GROWTH SUFFICIENT TO ALLEVIATING THE LINGERING HIGH RATES OF UNEMPLOYMENT AND WORK TO RECTIFY INTERNATIONAL BALANCE OF PAYMENTS DISEQUILIBRIUMS AMONG THEMSELVES.

3. IT IS FUNDAMENTAL HERE THAT EACH OF THE ADVANCED INDUSTRIAL NATIONS MAKE EVERY EFFORT TO EXPAND DEMAND WITHOUT REKINDLING INFLATION AND TO RECTIFY BALANCE OF PAYMENTS DISEQUILIBRIUM ACTING AS APPROPRIATE IN VIEW OF THE SITUATION PREVAILING IN THAT NATION, INCLUDING TACKLING THOSE FUNDAMENTAL AND STRUCTURAL PROBLEMS REQUIRING SOLUTION.

4. IF THESE VARIOUS EFFORTS BY THE DIFFERENT NATIONS ARE TO BEAR FRUIT, IT IS OF OVERRIDING IMPORTANCE THAT THE INTERNATIONAL CURRENCY SITUATION BE STABILIZED AND THAT THE FREE-TRADE SYSTEM BE MAINTAINED AND EVEN STRENGTHENED.

QUESTION: WHAT IS THE ECONOMIC OUTLOOK FOR THE DEVELOPING NATIONS?

ANSWER:

1. REALIZING THAT THE NON-OIL DEVELOPING NATIONS FACE SERIOUS PROBLEMS INCLUDING BALANCE OF PAYMENTS DEFICITS AND MOUNTING FOREIGN DEBT OBLIGATIONS AND AWARE OF THE ECONOMIC DIFFICULTIES FACING BOTH INDUSTRIALIZED AND DEVELOPING NATIONS, JAPAN'S BASIC ATTITUDE TOWARD ECONOMIC MANAGEMENT IN FY 1978 CALLED UPON JAPAN TO REDOUBLE ITS EFFORTS FOR INTERNATIONAL HARMONY.

2. ALTHOUGH THERE ARE HOPES FOR CONSPICUOUS GROWTH IN PRE-CAPITA GNP IN THE NATIONS OF EAST ASIA AND LATIN AMERICA, THE NATIONS OF SOUTH ASIA AND AFRICA CONTINUE TO

SECRET

SECRET

PAGE 03 TOKYO 07733 05 OF 09 281038Z

SUFFER FROM SLOW GROWTH.

3. LOOKING AT THE ECONOMIC FORECASTS MADE BY THE GOVERNMENTS OF THE MAIN ASIAN NATIONS, MOST OF THESE NATIONS ANTICIPATE A RATE OF ECONOMIC GROWTH IN 1978 EQUAL TO OR JUST SLIGHTLY UNDER THAT ACHIEVED IN 1977. THIS OUTLOOK IS BASED PRIMARILY ON THE LIKELIHOOD THAT THEIR EXPORTS WILL EXPAND MORE SLOWLY THAN IN 1977 SINCE (I) THE ADVANCED INDUSTRIAL NATIONS' ECONOMIC RECOVERY IS STILL

AILING AND (II) STIFFER IMPORT RESTRICTIONS ARE EXPECTED FROM THE EC AND OTHER IMPORTANT MARKETS. AS A CONSEQUENCE, THESE DEVELOPING NATIONS PLAN TO PUT THEIR POLICY EMPHASIS ON STIMULATING DOMESTIC DEMAND.

4. BY WAY OF REFERENCE, OECD ECONOMIC OUTLOOK FIGURES ARE GIVEN BELOW.

- 1970-73 1973 1974 1975 1976 1977 1978

- AVERAGE

CURRENT ACCOUNTS (EXCLUDING OFFICIAL TRANSFERS)

OECD 11-1/4 11-1/2 -22 6-1/2 -13-1/4 -18-1/4 -8

OPEC 4 9 63-1/4 32-1/4 44-1/4 42-1/2 38

NON-  
OIL

LDCS 13 -14-1/4 -33-1/4 -50-1/2 -36-3/4 -33-1/2 -45-1/2

SECRET

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SECRET

PAGE 01 TOKYO 07733 06 OF 09 281046Z

ACTION SS-25

INFO OCT-01 ISO-00 SSO-00 /026 W

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FM AMEMBASSY TOKYO

TO SECSTATE WASHDC IMMEDIATE 7548

S E C R E T SECTION 06 OF 09 TOKYO 07733

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OTHERS

2-1/2 -5 -9-1/4 -17-1/2 -12-3/4 -10-3/4 -11

CURRENT ACCOUNTS (EXCLUDING OFFICIAL TRANSFERS)

OECD 4-1/4 2-3/4 -32-3/4 -6-1/4 -26-1/2 -32 -22-1/2

OPEC 4 9 61-3/4 30-3/4 42-1/4 40 35

NON-  
OIL  
LDCS 7-3/4 -8 -24-1/2 -40 -26-1/4 -22-1/2 -33-1/2

OTHERS

3 -5-1/2 -9-3/4 -18 -13-1/4 -11-1/4 -11-1/2

NOTES: 1. THE 1970-73 AVERAGE IS A SIMPLE AVERAGE FOR THE  
- FIGURES FOR THESE YEARS.

- 2. VALUES ARE IN BILLION (10.9) DOLLARS.

QUESTION: WHAT ARE THE ECONOMIC AND POLITICAL CONSTRAINTS  
WHICH WOULD INHIBIT A PUSH FOR FASTER GROWTH?

ANSWER: JAPAN IS SEEKING TO ACHIEVE STABLE GROWTH AND  
BALANCED ECONOMIC DEVELOPMENT, AND IT IS FEARED THAT ANY  
EFFORT TO ACHIEVE A GROWTH RATE IN EXCESS OF THE GOVERN-  
MENT'S 7 PERCENT TARGET MIGHT INVITE A REKINDLING OF

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SECRET

PAGE 02 TOKYO 07733 06 OF 09 281046Z

INFLATION. IN ADDITION, THERE ARE ALSO A NUMBER OF  
FISCAL AND MONETARY CONSTRAINTS TO SEEKING FASTER-THAN-  
TARGETED GROWTH.

1. FISCAL CONSTRAINTS

- I. THE JAPANESE DEPENDENCE UPON GOVERNMENT BOND  
ISSUES IS MUCH HIGHER THAN IN OTHER NATIONS BECAUSE JAPAN  
HAS HAD TO CONDUCT MASSIVE ISSUES SINCE 1975 TO OFFSET  
THE SLUGGISH GROWTH IN TAX REVENUES AND FOR OTHER REASONS.

- II. EVEN WITHIN THIS HEAVY DEPENDENCE UPON BOND  
ISSUES, THERE IS ESPECIALLY HEAVY RELIANCE UPON SPECIAL  
BONDS TO FINANCE PERSONNEL COSTS AND OTHER SUCH CURRENT-  
ACCOUNT ITEMS WHICH DO NOT RESULT IN THE CREATION OF  
TANGIBLE ASSETS.

- III. PRELIMINARY PROJECTIONS OF THE GOVERNMENT'S  
FINANCIAL BALANCE INDICATE THAT, DEPENDING UPON HOW  
GREATLY DISBURSEMENTS CAN BE CURTAILED, IT WILL BE  
NECESSARY TO PROCURE ADDITIONAL TAX REVENUES TOTALLING BE-  
TWEEN YEN 5 - 10 TRILLION (10.12) IN THE JFY 1979-82  
PERIOD IF JAPAN IS TO CURE ITS DEPENDENCE UPON SUCH  
SPECIAL BOND ISSUES BY JFY 1982.

- IV. TO EXPAND DEFICIT SPENDING UNDER CURRENT  
CONDITIONS WOULD (A) LEAD TO AN UNCHECKED BLOATING IN  
GOVERNMENT SPENDING POSSIBLY GENERATING SERIOUS INFLATION,  
(B) INCUR A HEAVIER SERVICE BURDEN FOR THESE GOVERNMENT  
BONDS AND THUS MAKE IT STILL MORE DIFFICULT TO RESTORE  
SOUND FINANCIAL PRACTICES AND TO IMPLEMENT THOSE POLICIES  
TRULY IN THE BROAD PUBLIC INTEREST, AND (C) GENERATE,  
DEPENDING UPON FUTURE ECONOMIC DEVELOPMENTS, CROWDING-

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PAGE 03 TOKYO 07733 06 OF 09 281046Z

OUT AND OTHER PROBLEMS IN REDEEMING THE VAST VOLUME OF GOVERNMENT BONDS OUTSTANDING.

2. MONETARY CONSTRAINTS

EVEN IF THE OFFICIAL DISCOUNT RATE IS LOWERED STILL FURTHER, THE FINANCIAL INSTITUTIONS' BUSINESS POSITIONS, THE NEED TO MAINTAIN ATTRACTIVE INTEREST RATES FOR SAVINGS ACCOUNTS, AND OTHER PROBLEMS MAKE IT UNLIKELY THAT THIS WOULD BE REFLECTED IN A COMMENSURATE REDUCTION IN LENDING INTEREST RATES.

3. NEED FOR CURRENCY EXCHANGE STABILIZATION

INTERNATIONAL EXCHANGE STABILIZATION FOR THE YEN AND OTHER CURRENCIES IS PREREQUISITE TO THE ATTAINING OF ECONOMIC FORECASTS AND TARGETS.

- THE JAPANESE ECONOMY CAN NOT HELP BEING AFFECTED BY INTERNATIONAL ECONOMIC FLUCTUATIONS IN TODAY'S HIGHLY INTERDEPENDENT GLOBAL ECONOMY, YET IT SHOULD GO WITHOUT SAYING THAT THE GOVERNMENT'S ECONOMIC FORECASTS AND TARGETS ARE NECESSARILY PREMISED UPON THE ASSUMPTION OF REASONABLE STABILITY IN CURRENCY EXCHANGE AND OTHER BASIC INTERNATIONAL ECONOMIC ASPECTS. (FOR EXAMPLE, THE YEN'S ABRUPT APPRECIATION WAS A MAJOR FACTOR FORCING THE GOVERNMENT TO REVISE ITS JFY 1977 REAL ECONOMIC GROWTH RATE OF 6.7 PERCENT DOWNWARD.)

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PAGE 01 TOKYO 07733 07 OF 09 281053Z  
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FM AMEMBASSY TOKYO  
TO SECSTATE WASHDC IMMEDIATE 7549

S E C R E T SECTION 07 OF 09 TOKYO 07733

EXDIS

QUESTION: WHAT IS THE OUTLOOK FOR PLANT INVESTMENT?  
WHAT ARE THE IMPEDIMENTS TO PLANT INVESTMENT? ETC.

ANSWER:

L. OUTLOOK FOR JFY 1978 AND BEYOND

ACCORDING TO RECENT BUSINESS SURVEYS BY PRIVATE INSTITUTIONS OF THE BIG COMPANIES' PLANS FOR PLANT INVESTMENT IN JFY 1978, A 9 - 10 PERCENT INCREMENT IS EXPECTED CENTERING UPON (A) INVESTMENT BY THE ELECTRICAL POWER COMPANIES TO ENSURE LONG-TERM SUPPLY CAPACITIES, (B) INVESTMENT BY PETROLEUM COMPANIES SEEKING RAPID IMPROVEMENT IN THEIR STORAGE AND SAFETY FACILITIES, AND (C) INVESTMENT BY SUCH TERTIARY-SECTOR INDUSTRIES AS WHOLESALING, RETAILING, AND LEASING. SMALL AND MEDIUM-SIZED FIRMS ARE ALSO EXPECTED TO FOLLOW SUIT WITH SIMILAR INVESTMENT INCREMENTS, SUCH THAT IT WILL THUS BE POSSIBLE TO MEET THE GOVERNMENT'S TARGET-FORECAST FOR JFY 1978.

THE INVESTMENT CLIMATE IS EXPECTED TO BE EVEN BETTER IN JFY 1979 AS PRIVATE-SECTOR DEMAND PICKS UP STILL FURTHER, OPERATING RATIOS ARE IMPROVED, INVENTORY ADJUSTMENTS ARE EFFECTED, AND THE ECONOMY IS OTHERWISE RESTORED TO HEALTH, INCLUDING THE BENEFITS OF POLICY MEASURES TAKEN TO AID STRUCTURALLY DEPRESSED INDUSTRIES.

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PAGE 02 TOKYO 07733 07 OF 09 281053Z

2. IMPEDIMENTS TO EXPANSION OF PLANT INVESTMENT

I. SHORT-TERM IMPEDIMENTS TO PLANT INVESTMENT EXPANSION

A. FIRST IS THE SLUGGISH AGGREGATE DEMAND AND THE EXISTENCE OF EXCESS SUPPLY CAPACITY. AGGREGATE DEMAND IS ESPECIALLY SLUGGISH IN THE PRIVATE PLANT INVESTMENT AND HOUSING INVESTMENT SECTORS WHICH ARE PARTICULARLY EFFECTIVE IN GENERATING INDUCED INVESTMENT.

B. ALSO TO BE CONSIDERED IS THE INCREASED COST OF INVESTMENT AS A RESULT OF THE OIL CRISIS. ALTHOUGH SOME PROGRESS HAS BEEN MADE IN ESTABLISHING A NEW PRICE STRUCTURE COMMENSURATE WITH CONDITIONS SUBSEQUENT TO THE OIL CRISIS, THERE ARE STILL PROBLEMS IN ADJUSTING THIS STRUCTURE TO TAKE ACCOUNT OF HIGHER INVESTMENT COSTS.

II. MEDIUM- AND LONG-TERM STRUCTURAL CHANGES IN THE JAPANESE ECONOMY IMPEDING PLANT INVESTMENT

A. THE LULL IN TECHNOLOGICAL INNOVATION AND THE ABSENCE

OF PROMISING GROWTH PRODUCTS FOR THE FUTURE.

B. INCREASING UNCERTAINTY ABOUT THE GLOBAL ECONOMIC OUTLOOK.

C. ANXIETY OVER RAW MATERIAL AND ENERGY SUPPLY CONSTRAINS.

D. ENVIRONMENTAL CONCERN AND RESULTANT STRONG PUBLIC RESISTANCE TO POSSIBLY HARMFUL INDUSTRIAL PLANTS.

3. POLICIES TO STIMULATE PLANT INVESTMENT

I. THE FOLLOWING MEASURES ARE BEING IMPLEMENTED IN  
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PAGE 03 TOKYO 07733 07 OF 09 281053Z

JFY 1978 TO ALLEVIATE SHORT-TERM IMPEDIMENTS AND TO STIMULATE INCREASED PLANT INVESTMENT.

A. EXPANSION OF AGGREGATE DEMAND

BECAUSE OF THE LACK OF DEMAND IS THE BIGGEST REASON FOR THIS SLUGGISHNESS IN PLANT INVESTMENT, GOVERNMENT FISCAL POLICIES TO EXPAND AGGREGATE DEMAND ARE VERY IMPORTANT FOR STIMULATING PLANT INVESTMENT. ACCORDINGLY, THE GOVERNMENT HAS EMBARKED UPON AN AMBITIOUS PROGRAM OF TREASURY DISBURSEMENTS CENTERING UPON PUBLIC WORKS PROJECTS TO ASSURE ATTAINMENT OF THE TARGETED 7 PERCENT RATE FOR JFY 1978.

B. TAX CREDITS AND OTHER POLICIES TO STIMULATE PLANT INVESTMENT.

AMONG THE POLICIES IMPLEMENTED TO REDUCE THE COSTS OF, INVESTING AND TO FACILITATE PLANT INVESTMENT EXPANSION ARE (I) A TAX CREDIT FOR SMALL AND MEDIUM-SIZED FIRMS INVESTING IN NEW PLANT OR ANTI-POLLUTION FACILITIES, (II) INCREASED GRANTS FROM THE NATIONAL TO LOCAL GOVERNMENTS TO FACILITATE SITE ACQUISITION FOR ELECTRICAL POWER GENERATING PLANTS, (III) INCREASED GRANTS FROM THE NATIONAL TO LOCAL GOVERNMENTS TO FACILITATE SITE ACQUISITION FOR PETROLEUM STORAGE FACILITIES, AND (IV) ACCELERATED ORDERS FOR THE ELECTRICAL POWER INDUSTRY.

II. A NUMBER OF MEASURES ARE ALSO PLANNED OR UNDER WAY TO ALLEVIATE LONGER-TERM IMPEDIMENTS TO

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PAGE 01 TOKYO 07733 08 OF 09 281101Z  
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TO SECSTATE WASHDC IMMEDIATE 7550

S E C R E T SECTION 08 OF 09 TOKYO 07733  
EXDIS

INCREASING PLANT INVESTMENT. PRIMARY AMONG THESE ARE EFFORTS TO PROMOTE INTERNATIONAL HARMONY AND TO LESSEN THE AREAS OF UNCERTAINTY SUCH AS BY SEEKING STABILIZATION OF INTERNATIONAL CURRENCY EXCHANGE RATES, TO ALLEVIATING BUSINESS FOREBODINGS OVER THE GLOBAL ECONOMIC SITUATION, AND TO EXPAND INVESTMENT OPPORTUNITIES BY PROMOTING CONTINUED TECHNOLOGICAL DEVELOPMENT.

4. IMPACT OF EXPANDED PLANT INVESTMENT UPON DEMAND AND SUPPLY CAPACITY

BECAUSE THE INCREASE IN PLANT INVESTMENT IN JFY 1978 IS EXPECTED TO CENTER UPON SUCH NON-MANUFACTURING SECTORS AS THE ELECTRICAL POWER AND SERVICE INDUSTRIES, IT IS FELT THE DEMAND THUS GENERATED WILL CONTRIBUTE SUBSTANTIALLY TO ALLEVIATING THE DOMESTIC EXCESS SUPPLY POSITION. AT THE SAME TIME, IN THE FACE OF THIS ADVERSE SUPPLY-DEMAND GAP, MANUFACTURING INDUSTRIES ARE EXPECTED TO INVEST LESS IN PLANT AND EQUIPMENT THAN THEY DID IN JFY 1977, SUCH THAT THERE WILL THUS BE LITTLE ADDITIONAL SUPPLY CAPACITY GENERATED.

QUESTION: HOW DO INDUSTRY OPERATING RATIO TRENDS LOOK?

ANSWER:

L. THE INDUSTRIAL OPERATING INDEX (WHICH SHOWS THE RATIO OF CAPACITY BEING UTILIZED IN COMPARISON WITH THE LEVEL IN THE BASE YEAR OF 1975 ASSIGNED A VALUE OF SECRET

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PAGE 02 TOKYO 07733 08 OF 09 281101Z

100) REACHED A HIGH OF 109.9 IN MARCH 1977 BUT SUBSEQUENTLY FELL FOR FOUR STRAIGHT MONTHS AFTER THAT. HOWEVER, AFTER CONTINUING SLUGGISH UNTIL OCTOBER, IT HAS SINCE RECOVERED TO REGAIN THE 109.0 LEVEL IN FEBRUARY 1978. BECAUSE IT IS EXPECTED THAT MINING AND MANUFACTURING

PRODUCTION LEVELS WILL IMPROVE AS DEMAND INCREASES, THIS OPERATING INDEX IS ALSO EXPECTED TO SHOW FURTHER IMPROVEMENT.

2. LOOKING AT THE INDUSTRIAL PRODUCTION CAPACITY INDEX (ALSO TAKING 1975 AS THE BASE YEAR OF 100), THIS SHOULD ONLY SLOW GROWTH IN 1975 AND 1976, YET THE RATE OF INCREASE HAS PICKED UP SOMEWHAT SINCE FIRST-HALF 1977.

LOOKING AT CAPITAL STOCK (IN CONSTANT 1970 PRICES), THE RATE OF INCREASE HAD SLOWED EVERY YEAR SINCE 1974, YET HAS OWN SOME IMPROVEMENT SINCE EARLY 1977. ALTHOUGH THERE HAS BEEN SOME DISCREPANCY BETWEEN THE PRODUCTION CAPACITY AND CAPITAL STOCK INDICES, THIS IS ATTRIBUTABLE TO THE VERY HEAVY INVESTMENT IN ANTI-POLLUTION FACILITIES IN THE 1974-76 PERIOD, SUCH THAT INCREASED CAPITAL STOCK DID NOT NECESSARILY MEAN INCREASED PRODUCTION CAPACITY.

- 1973 1974 1975 1976 1977

OPERATING RATIO INDEX 91.7 97.8 100.0 102. 106.4  
(COMPARED TO PREVIOUS N.A. 6.7 2.2 2.8 3.5  
QUARTER)

PRODUCTION CAPAC.INDEX 94.5 99.5 101.2 104.3 107.0  
(COMPARED TO SAME N.A. 5.3 L.7 3.1 2.6  
QUARTER OF PREV. YEAR)

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PAGE 03 TOKYO 07733 08 OF 09 281101Z

CAPITAL STOCK 52167 56731 60121 63073  
(COMPARED TO SAME 10.0 8.7 6.0 4.9  
QUARTER OF PREV. YEAR)

TABLE CONTINUED

- 1977 1978  
- 1ST 2ND 3RD 4TH  
-- QTR QTR QTR JAN. FEB.

OPERATING RATIO INDEX 109.9 108.0 106.5 106.5 109.4 109.0  
(COMPARED TO PREVIOUS 0.5 -L.7 -L.4 0 L.L -0.4  
QUARTER)

PRODUCTION CAPAC.INDEX 105.6 106.3 107.0 107.0 107.0 107.L  
(COMPARED TO SAME 3.5 3.7 3.6 2.6 L.5 1.6  
QUARTER OF PREV. YEAR)

CAPITAL STOCK 64254 64779 65693  
(COMPARED TO SAME 5.8 5.8 5.3  
QUARTER OF PREV. YEAR)

NOTE: L. BASE YEARS ( 100) FOR BOTH THE OPERATING RATIO  
INDEX AND THE PRODUCTION CAPACITY INDEX ARE 1975.

2. BOTH PRODUCTION CAPACITY INDEX AND CAPITAL STOCK  
FIGURES ARE AS OF THE END OF THE PERIOD.

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PAGE 01 TOKYO 07733 09 OF 09 281121Z  
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FM AMEMBASSY TOKYO  
TO SECSTATE WASHDC IMMEDIATE 7551

S E C R E T SECTION 09 OF 09 TOKYO 07733  
EXDIS  
3. CAPITAL STOCK VALUES ARE IN BILLION YEN.  
RATIO OF ANTI-POLLUTION INVESTMENT TO ALL PLANT INVESTMENT

1970 - 5.3 PERCENT, 1971 - 6.5 PERCENT, 1972 - 8.3 PERCENT,  
1973 - 9.8 PERCENT, 1974 - 13.4 PERCENT,  
1975 - 17.1 PERCENT, 1976 - 15.2 PERCENT, 1977 - 9.5  
PERCENT  
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**Decaption Note:** 25 YEAR REVIEW  
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